COMMONWEALTH OF KENTUCKY

BEFORE THE ENERGY REGULATORY COMMISSION

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In the Matter of

ADJUSTMENT OF RATES FOR WHOLESALE ELECTRIC POWER TO MEMBER COOPERATIVES OF EAST KENTUCKY POWER COOPERATIVE, INC.	)))	CASE NO. 7702

ORDER

On January 17, 1980, East Kentucky Power Cooperative, Inc. (Applicant or East Kentucky) filed an application with this Commission requesting authority to increase its revenue by $8,576,789 annually or approximately 8.7%, effective 12:01 a.m., Eastern Standard Time, February 7, 1980. Applicant stated that the proposed rate adjustment was required due to (a) constantly increasing interest costs; (b) increasing construction costs; (c) inflation; (d) compliance with environmental laws; and, most importantly, (e) the deteriorating financial condition.

On January 21, 1980, the Commission ordered the proposed rate increase suspended until July 7, 1980, in order to conduct public hearings and investigations on the reasonableness of the proposed rates. A hearing was scheduled for February 15, 1980, at the Commission's offices in Frankfort, Kentucky, and Applicant was directed to give notice to its consumers of the proposed rates and the scheduled hearing pursuant to 807 KAR 50:025 Section 7.

On January 22, 1980 the Consumer Intervention Division in the Department of Law filed a Motion to intervene in these proceedings pursuant to KRS 367.150 (8). This motion to intervene was sustained at the hearing conducted on February 15, 1980, and no other parties appeared to formally intervene herein.

Additional hearings were conducted on March 20, and May 14, 1980 for the purpose of cross-examination of Applicant's witnesses and the witness for the intervenor.

Orders directing East Kentucky to file additional information were issued on March 7, 17, 18, 21 and May 21, 1980. Also, the Consumer Intervention Division made requests for additional information. Responses to these requests were filed and the matter was submitted to the Commission for final determination.

COMMENTARY

East Kentucky Power is a non-profit electric cooperative established pursuant to KRS Chapter 279 and is in the business of generation and transmission of electric energy to its eighteen member distribution cooperatives who jointly share in the ownership of East Kentucky. These distribution cooperatives serve approximately 1,000,000 consumers in over 90 counties in central and eastern Kentucky. Although the increase in rates requested by East Kentucky is directly to the 18 member distribution cooperatives the impact of any increase to East Kentucky is indirectly born by the consumers of the distribution cooperatives. Accordingly, these distribution cooperatives have filed applications with the Commission requesting authority to flow-through any increase granted East Kentucky in this matter. Contained in exhibit "B" attached hereto is a listing of the member distribution cooperatives and the impact of the proposed revenue and the revenue granted herein on their annual purchased power costs.

In October of 1979 at the time the order was issued in the preceeding East Kentucky rate case, the Commission expressed concern over the serious differences existing between the Board of Directors and the operating management of East Kentucky. Applicant testified in this proceeding that the differences between management and the board had been resolved. Applicant has also reestablished a favorable relationship with the Rural Electrification Administration and the borrowing restrictions have been lifted. The Commission commends East Kentucky for the progress that has been made on these issues.

TEST PERIOD

East Kentucky proposed, and the Commission has accepted the twelve month period ending October 31, 1979 as the test period herein. In utilizing the historic test period the Commission has given due consideration to known and measurable adjustments, where found reasonable.

VALUATION

Net Investment

Applicant proposed a net investment rate base of $482,450,022 based on the outstanding account balances at the end of the test period, as reflected on Exhibit IV of the application. Applicant also proposed an adjusted net investment rate base of $587,464,467, which reflects the projected plant in service and construction work in progress.

The Commission will accept the projected net investment rate base for East Kentucky with these exceptions.

(1) The Commission will utilize the thirteen month average of materials and supplies and fuel stock to reflect these investments. The Commission has also included prepayments at the thirteen month average which was not proposed in applicants' net investment rate base.

(2) Working capital and the accumulated reserve for depreciation have been adjusted to include the accepted pro forma adjustments. In making these adjustments the Commission is giving recognition to the changing operating conditions of East Kentucky. Based on these adjustments Applicant's adjusted Net investment rate base is as follows:

Plant in Service	$ 317,179,418
Construction Work in Progress	301,718,108
Fuel Stock	10,630,356
Materials & Supplies	6,806,286
Prepayments	1,434,964
Working Capital	8,278,117
Subtotal	$ 646,047,249
Less: Accumulated Depreciation	59,020,473
Net Investment	$ 587,026,776

Capital Structure

East Kentucky proposed an adjusted capital structure of $564,895,284 consisting of $8,277,722 of Equity, $22,500,000 in short-term debt, and $534,117,562 of Long-term debt which included funds that had not yet been advanced at the end of the test period. The Commission will accept the projected Long-term debt, and the short term debt components of this capital structure but will adjust the equity to reflect the actual equity at the end of the test period which was $4,544,464. The net result of this adjustment will reduce the proposed capital structure to $561,162,026.

The Commission has given consideration to these and other elements of value in determining the reasonableness of the proposed rates and charges.

REVENUE AND EXPENSES

East Kentucky presented a consolidated Statement of Operations for the twelve month period ending October 31, 1979 as Exhibit I. Applicant proposed numerous pro-forma adjustments to revenue and expenses to reflect more current and anticipated operating conditions.

After a thorough review of the proposed adjustments the Commission finds that they are generally acceptable and will include all of the adjustments with these modifications:

(1) In normalizing the test year revenue East Kentucky based the revenue produced by the current rates on the actual billings for the test period. In so doing East Kentucky did not give recognition to the additional revenue that would be collected as a result of substations that were added during the test period. Therefore, the Commission has adjusted the normalized revenue by $3,560 to reflect the additional revenue to be collected.

(2) On Exhibit 1B, Schedule c Applicant proposed an adjustment to Other Power Supply Expense to reflect increased losses on power purchases from the Kentucky-Indiana Pool due to contractual obligations to increase the amount of power purchased from that pool. In determining the projected losses from these power transactions East Kentucky used estimated purchase and sales prices based on the best information available at the time of the filing, which resulted in a proposed adjustment of $1,592,460.

During the course of these proceedings it was determined that an error had been made in determining the actual losses on these power transactions during the test year. Applicant also submitted additional information which reflected the actual prices of power purchases and sales within the Kentucky-Indiana Pool.

Based on calculations using the revised information the Commission is of the opinion that $1,248,240 of the proposed adjustment should be disallowed.

(3) On Exhibit 1B, Schedule b, East Kentucky proposed an adjustment of $78,332 to reflect a normal level of expense for conservation program activities. The Commission is of the opinion that the record does not support the inclusion of the total projected salary expense associated with these activities. Therefore, the Commission will reduce the proposed adjustment by $24,900.

(4) On Exhibit 1B, Schedule f East Kentucky proposed an adjustment to right-of-way maintenance of $291,161, to reflect a normal level of expense for right-of-way spraying and clearing. Applicant stated that due to the present financial straints the test year expense was well below normal.

Applicant presented evidence that the projected costs for right-of-way spraying had been understated in the application and submitted evidence supporting a current cost of $182 per acre for aerial spraying. The record did not however, support the projected levels of emergency right-of-way clearing.

The Commission is of the opinion that maintenance of right-of-way is essential to the efficient operation of an electric utility and the operating revenue should be sufficient to cover all essential maintenance of this nature. Therefore, the Commission will increase the proposed adjustment to reflect the revised cost of aerial spraying by $69,190.

(5) The Commission has adjusted Other Income by $24,205 to exclude AFUDC incurred during the test period on the use of internal funds for capital expenditures inasmuch as this item will be offset by the projected Long-term debt and Interest capitalized.

After consideration of the accepted pro forma adjustments Applicant's statement of operations would appear as follows:

	Actual Exhibit I	Accepted Pro forma Adjustments	Adjusted Test Year
Operating Revenues			
Member Sales	$72,605,450	$10,490,168	$83,095,618
Sales for Resale	14,500,594		14,500,594
Other Revenues	493,079		493,079
Total	$87,599,123	$10,490,168	$98,089,291
Operating Expenses			
Operation	$66,841,584	$ 1,036,036	$67,877,620
Maintenance	5,030,410	537,304	5,567,714
Depreciation	8,147,671	1,701,537	9,849,208
Taxes	1,203,991	120,486	1,324,477
Total	$81,223,656	$ 3,395,363	$84,619,019
Net Operating Income or Margins	$ 6,375,467	$ 7,094,805	$13,470,272
Other Income	$ 480,555	$ 78,413	$ 558,968
Other Income Deductions	$ 2,237,203	$ -	$ 2,237,203
Interest on Long-Term Debt-Net	$10,138,624	$ 2,208,245	$12,346,869
Net Income or Margins	$(5,519,805)	$ 4,964,973	$(554,832)

REVENUE REQUIREMENTS

The actual rate of return on East Kentucky's Net Investment established herein for the test year was 1.09%. After taking into consideration the allowed pro forma adjustments, Applicant's rate of return is 2.29%.

East Kentucky placed little emphasis on the rate of return on Net Investment in this matter and no testimony was entered in opposition of the determination of the Net Investment rate base or the proposed returns. Instead, the main emphasis was concerning the required times interest earned ratio (TIER) which is the financial indicator contained in Applicant's mortgages securing its long-term debt.

The times interest earned ratio is a measure of the ability of the utility to cover its annual interest on long-term debt and is calculated by adding the net income to the interest on long-term debt and dividing by the interest on long-term debt. East Kentucky requested in this matter an annual net income level of $6,790,242. Based on the pro forma Interest on long-term debt of $37,932,939 this level of net income would produce a TIER of 1.179.

The Division of Consumer Intervention argued that a TIER of 1.10 would be adequate to allow East Kentucky to achieve the 1.0 TIER average for two out of three preceeding calendar years. Their witness further testified that he was not necessarily challenging the TIER requested by Applicant but questions the method used to establish that as the TIER objective.

The Commission is of the opinion that the requested TIER of 1.179 is not unreasonable in this instance. East Kentucky has failed to achieve the minimum TIER level for the past three years which has resulted in technical default on its mortgages. The record also reflects that if East Kentucky fails to earn a TIER OF .90 in any calendar year that it would result in a default on long-term debt secured through private investors in the total principle amount of $75,000,000, which could result in refinancing of this debt at a substantially higher interest rate to the detriment of the rate payers. East Kentucky became precariously close to that minimum requirement during 1979.

In order to achieve a TIER of 1.179 based on the adjusted test year East Kentucky would need additional revenue of approximately $7,345,000. This additional income would result in a rate of return based on the Net Investment established herein of 3.55% which is determined to be the reasonable rate of return granted herein.

OTHER ISSUES

The Commission has in the preceding East Kentucky rate case and in this proceeding inquired into the amount of land retained by East Kentucky in excess of current and foreseeable needs. The record indicates East Kentucky currently holds approximately 120 acres in proximity to its headquarters facilities in Clark County with no immediate plans for utilization for the benefit of the rate payers. East Kentucky has supplied limited information in response to Commission inquiries with regard to this and other land held for future use. The Commission is reluctant to interfere with management's decision to retain these properties but is of the opinion that a full reporting should be made of all property that is not presently in use.

SUMMARY

The Commission, after due consideration and being advised, is of the opinion and finds that the rates set out in Appendix "A" attached hereto are the fair, just, and reasonable rates for East Kentucky Power Cooperative, Inc. and will produce gross annual revenue of approximately $90,440,618. The Commission further finds that the rates and charges proposed by East Kentucky should be denied in that they produce revenue in excess of the amount determined to be reasonable herein.

IT IS THEREFORE ORDERED, that the rates set out in Appendix "A" attached hereto and made a part hereof are approved for service rendered on and after July 1, 1980.

IT IS FURTHER ORDERED, that the rates and charges proposed by East Kentucky Power Cooperative, Inc., are unfair, unjust, and unreasonable in that they produce revenue in excess of that deemed reasonable herein and are hereby denied.

IT IS FURTHER ORDERED, that East Kentucky shall file within ninety (90) days of the date of this Order a complete listing of all property not currently in use, including the cost and current value of the property, the annual cost to East Kentucky of maintaining the property and all other pertinent information, together with a statement which recites the complete justification for retention of these properties not being used for utility purposes.

IT IS FURTHER ORDERED, that East Kentucky Power Cooperative Inc. shall file with the Commission within thirty (30) days from the date of this Order its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this the 1st day of July, 1980.

ENERGY REGULATORY COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX "A"

APPENDIX TO AN ORDER OF THE ENERGY REGULATORY COMMISSION IN CASE NO. 7702 DATED JULY 1, 1980.

The following wholesale rates and charges are prescribed for the distributors served by East Kentucky Power Cooperative, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

Wholesale Power Rate Schedule

Monthly Rate - Per Substation or Metering Point:

Substation Charge:

$483 per month for each energized substation. In the event of joint utilization, this charge shall be divided equally.

Demand Charge:

$3.98 per KW of billing demand.

Energy Charge:

All KWH $ .01739 per KWH

Minimum Monthly Charge:

The minimum monthly charge under the above rate shall not be less than $ 483 to each member of each energized substation (metering point).

FUEL ADJUSTMENT

The fuel clause shall provide for adjustment per Kwh of sales when the cost of fuel per Kwh is above or below the base cost of fuel of 1.305¢ per Kwh.

The current monthly charges shall be increased or decreased by the product of the Kwh furnished during the current month and the Fuel Adjustment Rate where the Fuel Adjustment Rate is as defined below:

$$\text{Fuel Adjustment Rate} = \frac{F(m)}{S(m)} - \frac{F(b)}{S(b)}$$

Where $F(m)/S(m)$ is the cost of fuel per Kwh in the previous month and $F(b)/S(b)$ is the cost of fuel per Kwh in the base period or 1.305¢ per Kwh.

APPENDIX "B"

APPENDIX TO AN ORDER OF THE ENERGY REGULATORY COMMISSION IN CASE NO. 7702 DATED JULY 1, 1980.

The following eighteen (18) rural electric distribution cooperatives (RECC's) are the owners and member-consumers of East Kentucky Power Cooperative, Inc. The RECC's purchase all of their electric requirements from East Kentucky Power and provide service to approximately one million (1,000,000) citizens in the Commonwealth.

NAME OF RECC	POWER COST INCREASE PROPOSED BY EKP	POWER COST INCREASE APPROVED IN THIS ORDER
Big Sandy	$ 298,768	$ 256,000
Blue Grass	341,093	292,000
Clark	394,825	338,000
Cumberland	515,380	442,000
Farmers	476,745	408,000
Fleming-Mason	538,148	461,000
Fox Creek	193,994	166,000
Grayson	258,434	221,000
Harrison Co.	244,383	209,000
Inter Co.	401,830	344,000
Jackson Co.	854,538	732,000
Licking Valley	355,052	304,000
Nolin	524,521	449,000
Owen Co.	658,255	564,000
Salt River	835,924	716,000
Shelby	251,755	216,000
South Ky.	957,486	820,000
Taylor Co.	475,658	407,000
TOTALS	$8,576,789	$7,345,000